Chain Store Age EXECUTIVE

with Shopping Center Age

The newsmagazine for retail operations

June 1984

Exclusive warehouse distribution survey

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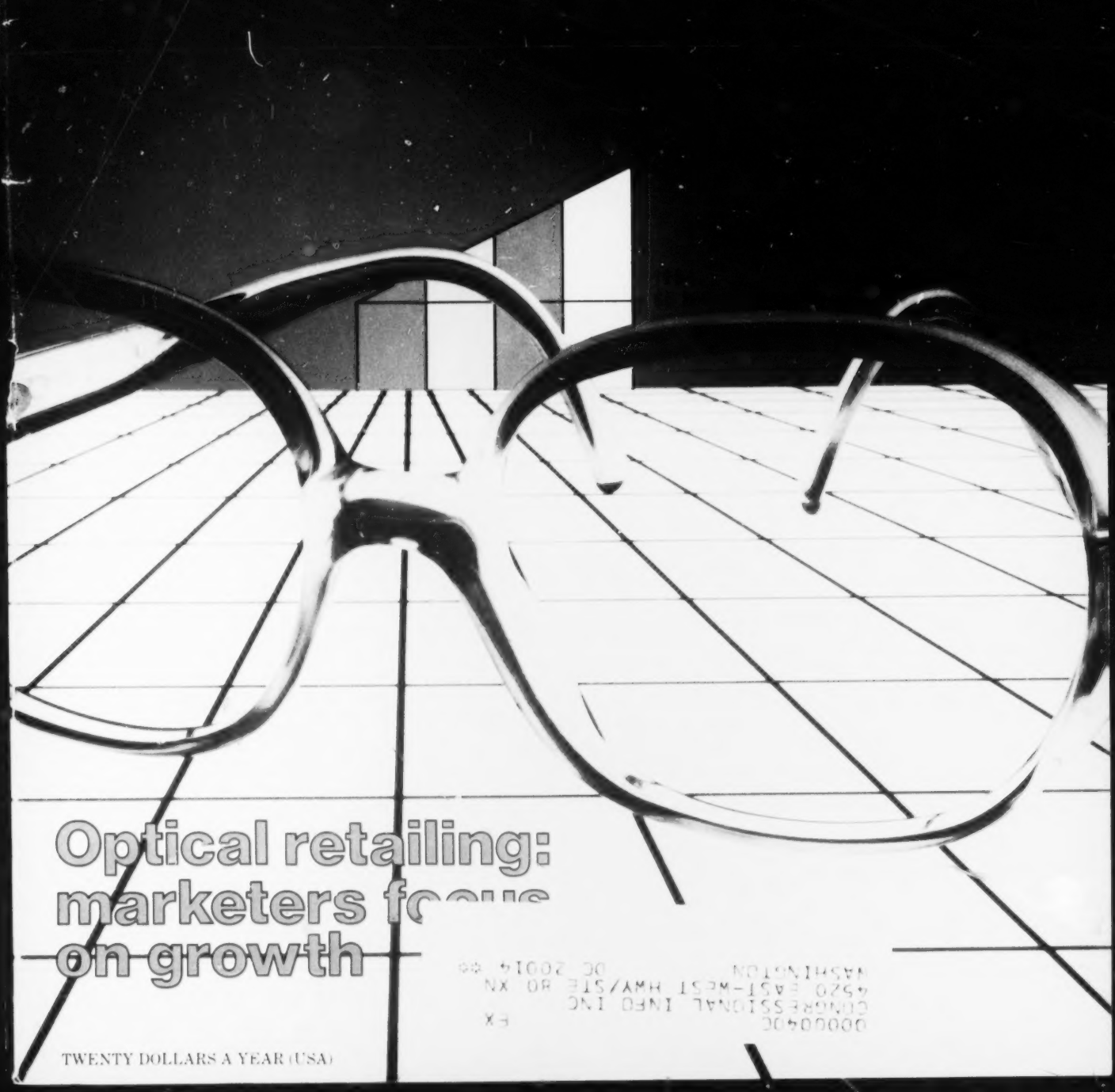

Optical retailing: marketers focus on growth

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CONTENTS

Chains pump 48% more into distribution . . . 15
Chain Store Age Executive's exclusive survey examines retailers' capital expenditures.

Oil analysis keeps Meyer on the road . . . 21
Truck maintenance system eliminates $46,000 dent in annual expenses.

Eyewear about to make a spectacle of itself . . . 23
Megaopticals, a new breed of specialty stores, may be on the way to being a $20 billion market in the next decade.

RETAIL TECHNOLOGY

Tom Thumb ups efficiency with computer backtalk. . . 32
Supermarket chain reports vast improvements in distribution efforts with voice-response order entry system.

Goudchaux telecommunications system speeds service . . . 35
Louisiana department store chain links stores with digital network.

Phone rate hike squeezes chains . . . 43
For some retailers, telecommunications systems expenditures may hit $1 million per year.

Stop & Shop goes 100% scanning . . . 44
Management information is the payback for Boston-based chain.

SHOPPING CENTER AGE

Center management: The Old Gray Mare . . . 46
As the shopping center industry increases in sophistication, so must the professional skills of the mall manager.

5 From the Editor's Desk
6 Washington Commentary
6 F.Y.I.
8 Accounting Views
13 Executive Eye on Law & Government
50 Shopping Center Real Estate
53 Along the Mall
53 New Stores & Shopping Centers
56 Classified Advertising
59 Advertising Index
60 People in the News
60 SPECS Forum

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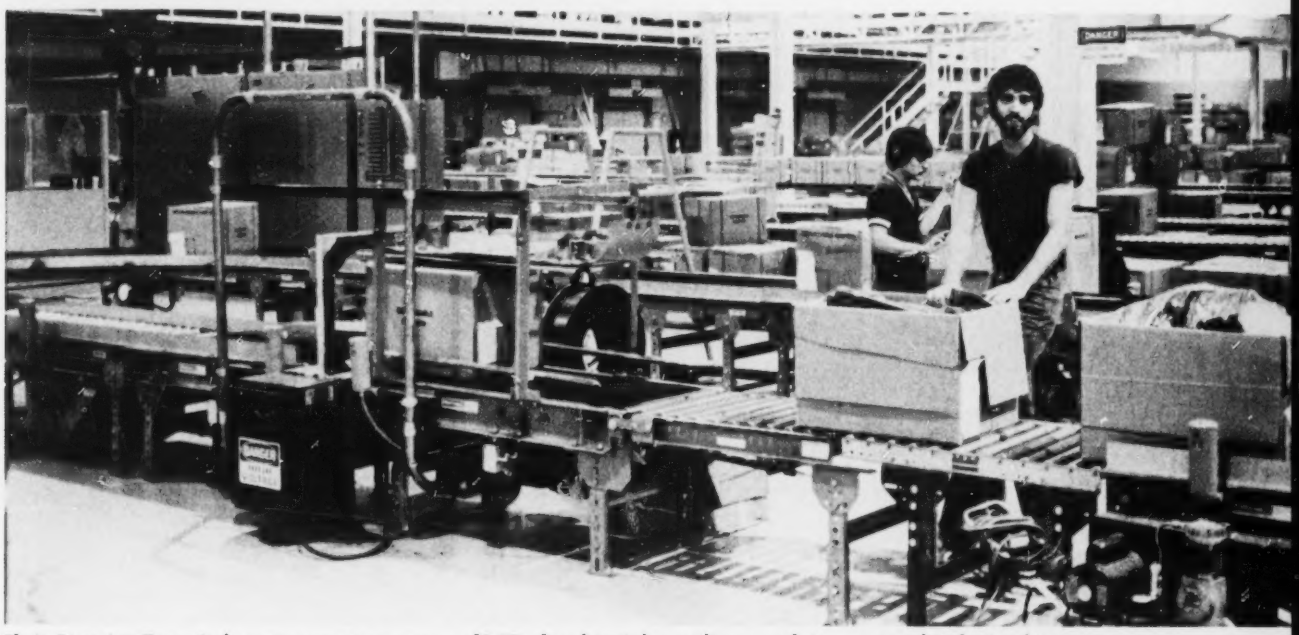
Chain Store Age EXECUTIVE June 1984



Chain Store Age Executive's *survey reports* *an average of 8.3% of total capital expenditures are being spent on distribution this year.*

DISTRIBUTION

Capital expenditures on the rise

Chain Store Age Executive's exclusive survey shows retailers pumping 48% more into their distribution budgets

Retailers are predicting a 48% increase in the distribution portion of their total capital expenditures in just two years, according to a survey taken by *Chain Store Age Executive*.

Expansion appears to be the major reason for the increase in spending. Adding more square footage to the distribution network is essential to keep pace with expanding networks of stores. Every class of retailer queried for the survey indicated that total distribution square footage will increase in 1984.

In addition to expenditures, the survey also examines:

- Construction costs per square foot.
- Productivity per square foot and per employee in distribution centers.
- Use of computer systems for receiving, pricing/ticketing, picking, shipping and sorting in distribution centers.
- Transportation, including equipment that is owned, leased or third party.

The survey shows that an average of 6.7% of capital expenditures were spent on distribution in 1983, and all categories of retailers are predicting an average of 8.3% this year and 9.9% in 1985.

All indications are that distribution managers are struggling to process greater and greater amounts of merchandise in a timely fashion while keeping the lid on costs.

As a result, most chains that are increasing distribution capacity will do so through expansion of existing buildings rather than new construction.

Since new construction costs an average of 13% more than expansion of existing facilities, the survey shows that 75% of the retailers who plan to increase distribution space in 1984 will do so by enlarging their present centers.

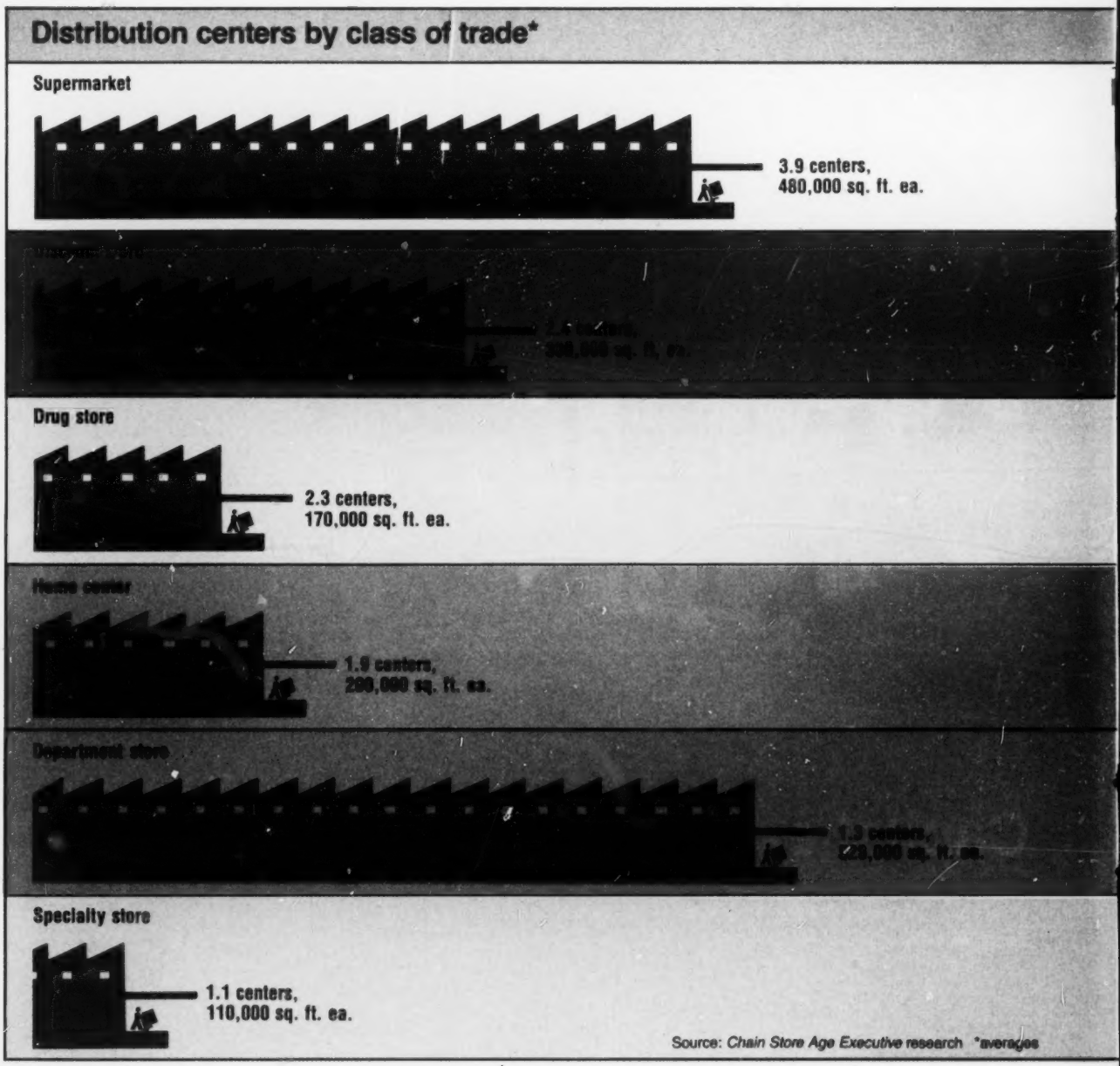
Only 18% of the chains surveyed plan new construction of distribution facilities in 1984. The total amount of newly constructed distribution space that will be added in 1984 averages 309,000 sq. ft. per chain. The amount of space to be added by expansion of existing facilities averages 67,000 sq. ft. per chain for all retailers surveyed.

The average cost of building new distribution centers is $29.10 per square foot. That figure includes the cost of site preparation, building, tow-line and HVAC. To expand an existing facility, measuring by the same criteria, the cost is an average of $25.40 per square foot.

According to the survey, there was only one class of retailing where expansion cost more than new construction. Drug store operators spent an average of $28.20 per square foot for expansion while new construction cost $27.50 per square foot in that industry.

Supermarkets report the highest new construction costs of any retail class. The food industry spends $33.80 for new distribution facilities and $31.70 per square foot to expand.

In contrast, home centers, without the special needs of food handlers, report the lowest cost for expanding



existing facilities—$20.30 per square foot. But department stores note the lowest cost for new construction; their building ticket comes to $25.90 a square foot.

The biggest increase in capital expenditures for distribution is occurring in discount chains, where mass retailers predict a whopping 154% increase in the portion of capital expenditures earmarked for distribution from 1983 through 1985.

In 1985, discounters plan to spend 16.3% of their capital expenditures budget on distribution and that's 33% higher than the next highest spender in the field. Home centers will place 12.3% of their capital expenditures in distribution centers.

Discount, home center and specialty stores plan to spend at least 10% of their capital expenditures budget on distribution facilities and expansion in the next year. Spending in the supermarket, drug and department store fields has leveled off or even declined slightly.

These industries appear to have more highly developed distribution networks in place and are expanding at a lesser rate. Department store distribution needs, for instance, will account for a relatively low 5.6% of the capital expenditures budget next year.

Only a small portion of the workforce is unionized in the retail distribution industry—an average of 35%. But payroll is a large part of the overall cost of distribution.

Payroll is a particularly hefty cost in the less automated sectors of retail distribution. The department store industry is the most prominent illustration. One Washington, D.C.-area department store distribution manager feels that the high payroll figure for department stores reported in this survey (63.3% of the distribution budget) may reflect the lower levels of automation in the industry's distribution operation.

The department store distribution centers also handle a more diverse mix of hard and soft goods than most other retailers. The level of unionization in department store workforce is one-third below the retail industry mean.

On average, retailers spend 44.9% of the distribution budget on payroll. Home centers have the lowest labor costs with 27.1% of their distribution

budget devoted to payroll. The number of workers employed per center in the department store industry is high—201 compared to a mean of 119 for all retailers represented in the survey.

Unionization does not appear to play a strong role in the overall cost of labor. Supermarkets and specialty stores both spend about half their distribution budgets on payroll, and supermarket distribution centers are 76% unionized while specialty store centers are only 21% unionized. Supermarkets, with the highest level of unionization, still allot 20% less of their budget to labor than do department stores.

This survey shows that 76% of supermarket distribution employees are card-carrying union workers, and the supermarket industry has chalked up impressive productivity numbers by one measure. Supermarket distribution workers handle an average of 860 cartons of goods per day compared to the retail mean of 487 cartons per employee each day. That performance has been achieved with an allotment of 50.4% of the distribution budget to payroll.

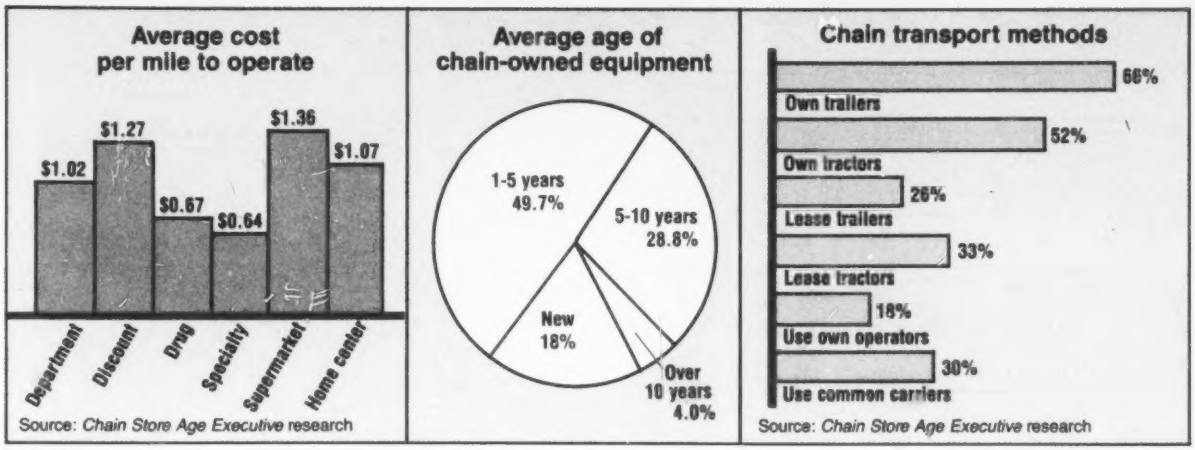
Supermarket distribution centers are highly automated. In terms of computerization, supermarkets lead in almost every function.

Receiving, picking, sorting and shipping are all computerized. Pricing and ticketing is the one function where supermarkets do not lead the retail industry in computerization. Only 27% of the ticketing that is done in the supermarket industry is computerized, but supermarkets do most of their price marking at the store level.

The supermarket distribution managers surveyed estimate that 26.3% of their ticketing is provided by vendors. The bar-coding of dry goods and canned goods puts supermarkets' average more than twice as high as the 12.8% mean reported by distribution executives in all sectors.

Department stores, on the other hand, have the least vendor participation in that process. Department store distribution managers estimate that only 9% of their ticketing is done by vendors.

Department stores also report the highest level of computerized pricing/ticketing operations in their distribution centers. The respondents



report that 87% of that function is computerized in department store distribution centers.

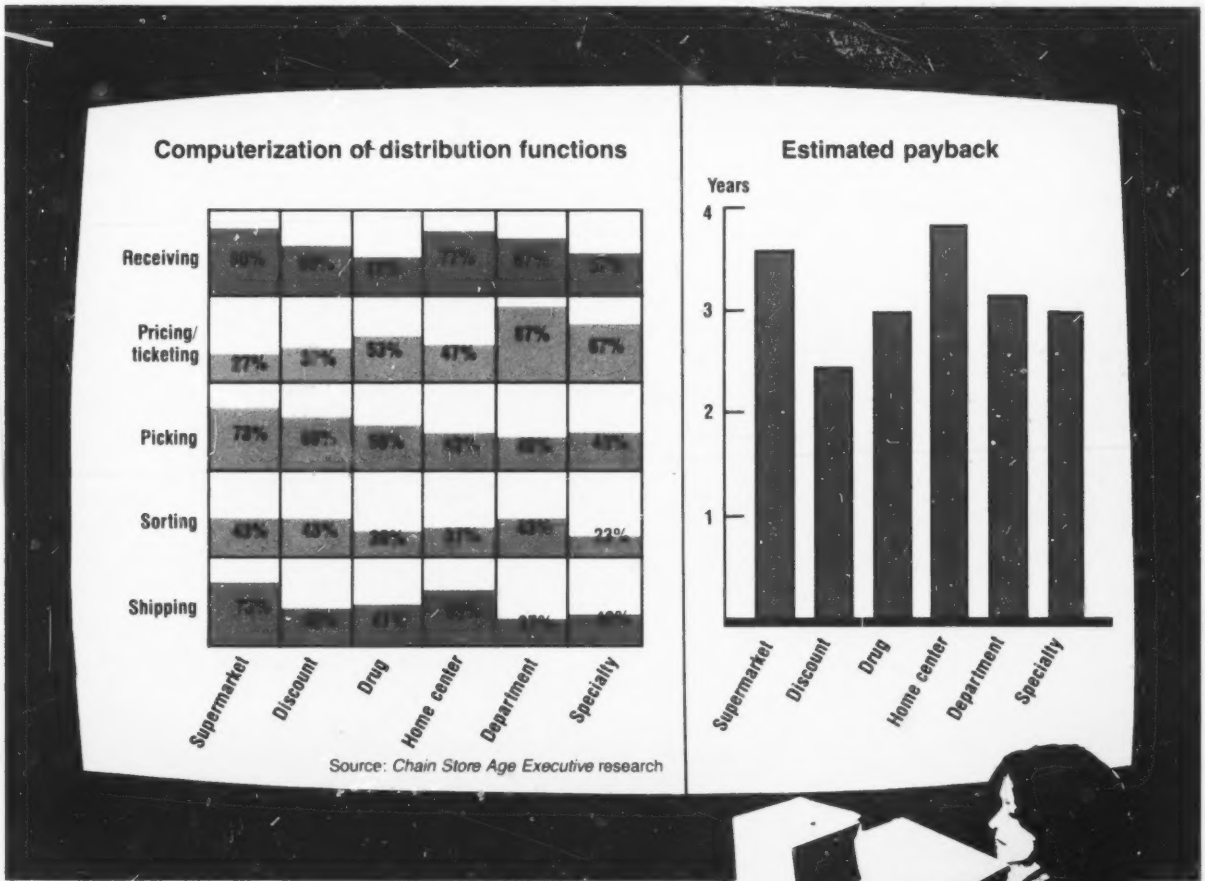
Deregulation has helped allay the near-term costs of shipping. Retailers say there is stronger price competition for chain contracts. But distribution managers are still uncertain of the long-term implications.

While trucking and rail concerns have lowered prices in some areas due to competitive pricing, these industries must also concentrate their efforts in the most productive geographic areas to keep pace with their own rising costs of fuel and labor.

Supermarket retail chains own more of their transportation equipment than any other retail sector. As a result, supermarkets devote a greater share of their distribution capital expenditures budget—32.3%—to trucks than any other class of retailing.

Discount and department stores come next, placing about a fifth of their capital expenditures into transportation equipment. Specialty store chains use common carriers to a greater extent than other retailers and also experience a good deal of drop shipping—therefore these chains only allot 6.6% of their distribution capital expenditures to transportation equipment.

Since transportation is one of the more volatile costs in the distribution budget, chains are anxious to trim costs or contain them wherever possible. About two-thirds of the retailers



Survey respondents

This article is based on a survey of 180 chains by *Chain Store Age Executive*.

The sample of qualified chains was taken from the top 100 chains in each of six retail sectors—supermarkets, discount stores, department stores, drug stores, home centers and specialty stores.

The average annual volume of the chains interviewed for this survey ranges from a low of $36 million for specialty stores to a high of $1.7 billion for supermarket chains. Discount operators average $789 million in annual volume and department stores come in third with $242 million. Home centers average $52 million in annual revenues and drug stores have $87 million.

The respondents to this survey, conducted by professional researchers via telephone interviews, are vp's of distribution, operations or warehousing. The 180 completed questionnaires are divided evenly with 30 respondents in each class of trade.

In the supermarket field the distribution executives are responsible for the most centers, 3.9 on average, and the most stores, an average of 242. Specialty store distribution executives have the smallest networks with an average of 36 stores in their chains served by 1.1 centers.

These chain store executives were queried on 30 separate points concerning the physical plants of their distribution centers, distribution as a component of capital expenditures, the distribution labor force, the role of computerized systems in distribution, ticketing and transport of merchandise.

surveyed use backhauling in their distribution operations, and 59% of the chains that backhaul do so to generate revenue.

At this point, however, less than half of all chains backhaul for profit. Virtually all supermarket chains backhaul, while only a third of specialty chains do.

School is still out on the question of whether retailing as an industry is moving toward larger central distribution centers or more localized networks. Some chains are moving away from managing distribution internally in favor of the exclusive use of outside carriers. But for maturing chains distribution management is becoming a key competitive tool as their strategy shifts from expansion to a concentrated effort to increase and maintain market share.

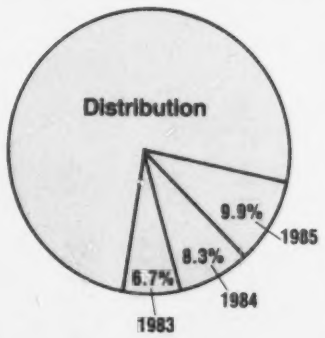
To that end, most retailers are employing ever more sophisticated automation processes including robotics, expanding transportation fleets and fine-tuning employee relations for increased productivity and cost-efficiency in the distribution center. ■

Distribution costs as a per cent of total capital expenditures

	Supermarket	Discount	Drug	Home center	Department	Specialty
1983	4.8%	6.4%	7.9%	9.0%	3.4%	9.5%
1984	6.5	5.4	7.4	12.7	6.3	11.1
1985 (projected)	7.3	16.3	7.9	12.3	5.6	10.0

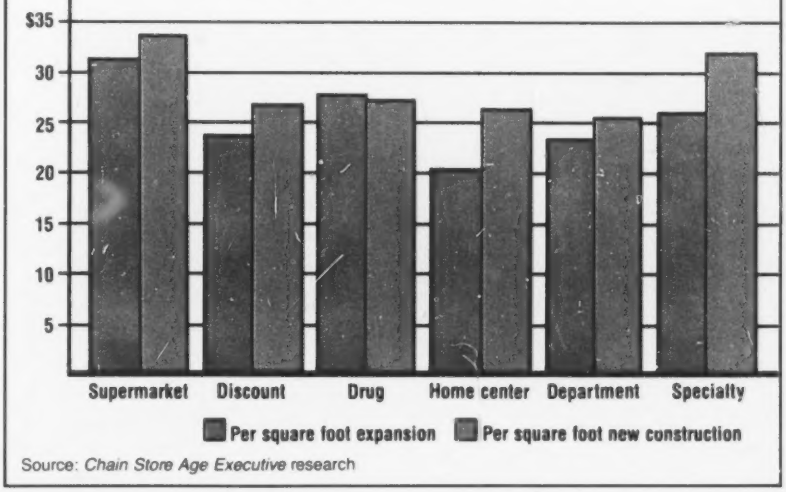
Source: *Chain Store Age Executive* research

Total retail capital expenditures



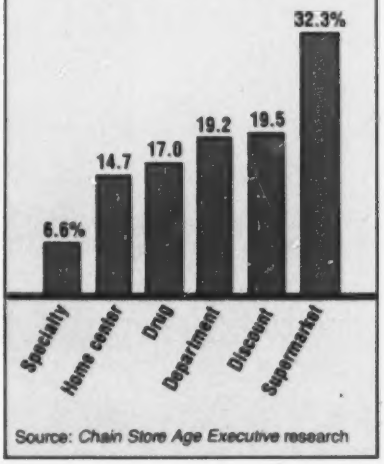
Source: *Chain Store Age Executive* research

Average construction costs



Source: *Chain Store Age Executive* research

Distribution expenditures for transportation equipment



Source: *Chain Store Age Executive* research

An estimated 35% of sales at Manhattan Eyeland come from the $45 eye examinations, well above the $25 to $30 average.

Eyewear about to make a spectacle of itself

Megaopticals, a new breed of eyewear department stores, may be on the way to being a $20 billion market

There are a dozen retailers sitting on a restless giant that's beginning to stir.

Philip G. Barach, chairman of U.S. Shoe, says reputable marketing studies have indicated that it will be the fourth fastest-growing area of retailing over the next decade.

It's a $5 billion market that looks like it will be $20 billion in the next decade. It's a new breed of eyewear department stores that peddle optical goods in 10,000 to 20,000 sq. ft. of sheer glitter with a pretax profit structure of 20% to 30%, and 10% after tax.

Right now megaoptical stores are cutting a sizable niche in the optical market. Most industry observers put their share at close to 20% currently and expect that it will grow closer to 33% in three to five years. That's not bad for an industry which is not yet four years old. An industry with stores with sales ranging from $1 million to $2.5 million, which translates to $100-$250 a square foot, isn't bad either.

Historically, the sale of eyeglasses has been treated as an appendage of the medical trade. That premise died in the late 1970's when doctors received legal clearance to advertise, and consumers were handed their prescriptions for the first time.

A highly determined group of marketing entrepreneurs started opening stores three years ago determined to provide the spectacle wearer with the same pizzazz that Bloomingdale's gave the parvenu. "Megaoptical" shops that stock upward of 5,000 frames, and as many contact lenses, retailing from $30 to $30,000, are devouring the market share of traditional shops one-tenth their size that sell a few hundred frames.

The stir that these retailers have caused prompted a $2.6 billion conglomerate, Quaker Oats, to pay $10 million for a five-unit pioneer eyewear chain called Eyelab. Currently operating in New Jersey and Long Island, the chain's annual sales are about $10 million. Observers note that the chain's management, being the originator of the department-store concept and the prospects for immediate growth through expansion sweetened the deal.

Approximately 20 of these megaoptical stores are currently operating around the country. Forty to 50 more are definitely slated for 1984 openings, and industry participants predict that there will be 150 of these stores in major metropolitan markets by the end of 1985.

All the chains surveyed for this story have active expansion plans. Other retail companies are reported to be on the verge of launching eyewear superstores. Chief among the repeatedly rumored startup candidates is the Eckerd Drug's launching of a chain called Vision Works in the Miami area. Spokesmen for Eckerd have no comment.

More are opting for opticals

"I don't believe that Quaker Oats or U.S. Shoe bought those chains (Eyelab and Precision Lens Crafters) because of the Baby Boom. They bought the superstores because they're innovative retailing and they could be the wave of the future," says Richard Golden, executive vp of D.O.C. Optics.

While some may well doubt that demographics are the only reason why so many businesses are opting to include optical superstores in the corporate lineup, there is no doubt that the numbers are suspicious.

A United States National Center for Health Statistics survey indicates that approximately half of the population over the age of 3 wears some type of corrective lenses. Moreover, a Roper survey found that 64% of all adults over the age of 18 wear prescription glasses.

Consumer spending habits are already changing, according to a recent Nielsen report which indicates a trend to specialty eyewear retailers. Nielsen reports that 50% of prescription shoppers went to an optical store for glasses, and only 38% were sold their glasses by a doctor. That's a far cry from the pre-1977 setup which did not require doctors to hand their patients the prescriptions. Leased departments in department stores only snared 4% of sales, drug stores chalked up a measly 2% and 6% went to "other" sources.

Whatever the outcome of the current all-out marketing war to increase consumer consumption levels among eyeglass wearers, the sheer number of eyeglass wearers is exploding. "In the last 20 years the heart of our market—35 to 54 year olds—went from 44 million to 47 million. In the next 20 years, that group will increase by 31 million people—not three million," says Jack Byrne, chairman of Manhattan Eyeland.

In addition to the basics there is a mushrooming market for fashion opticals, contact lenses to supplement glasses, and even purely cosmetic lenses to change the color of the eyes. The new breed of "retailers" in what has been viewed as a para-medical business will certainly profit.

In addition,

- Pearle Health Services is launching two superstores to be called Visionary this year.
- Eye + Tech of Houston plans to expand its four units through internal and external financing.
- D.O.C. Optics, which operates 95 conventional optical stores, and currently has the biggest eyewear store on record—23,000 sq. ft. in Hialeah, Fla.—will add three to five superstores in 1984.
- Precision Lens Crafters, a recent acquisition of U.S. Shoe, will "expand substantially in the next year" and "more than double" the current four-unit chain with more than a dozen stores slated for Chicago alone, according to Dean Butler, president.
- Cole National's World of Vision store in Pittsburgh will be joined by three sister stores in Minneapolis this year.
- Eyeworld of Framingham, Mass., will add three to six stores to the initial unit in the next five years.
- Quaker Oats is not saying how many new stores it will add to the Eyelab chain, but reports of real estate scouting in Chicago have not been denied.

Mark Schnarr, vp-planning and development of Quaker Oats, says that the players in the optical field are playing in an atmosphere of "up for grabs" expansion right now. He adds that Quaker's plan for Eyelab calls for it to become "not just another player, but the leading player."

Some of the operators of the new stores are not new to chain optical retailing. Pearle Vision Center operates more than 1,100 stores in the United States, Canada, Mexico, Belgium, Luxembourg, Britain and the Netherlands. Keith West, president of Minneapolis-based Benson Optical which operates 400 stores, comments that, "Pearle couldn't get as big as they are without taking some of our business."

On-site labs in the superstores generally employ 10 to 15 skilled technicians.

Pearle, a $305 million company with 1983 earnings of $17.3 million invested $11.5 million of capital in the business last year and went public in December of 1983. The strongest operator of traditionally sized optical stores, Pearle nonetheless takes the superstore trend seriously. Pearle plans to invest $18 million of capital in the business in 1984. In early March, the company launched two superstores, 7,000 and 10,000 sq. ft., called Visionary, in their own backyard in Dallas.

Donald J. Phillips, Pearle's president, pooh-poohs the media attention that superstores are attracting. "I think the whole thing is overplayed. None seems particularly strong. Margins aren't really that high," but industry startup costs for stores of this type range from a minimum of $500,000 to $1 million.

Pearle may be a case of "if you can't beat 'em join 'em," but many smaller operators are uncomfortable with the flow of outsiders into the optical business. Some are reluctant to discuss the superstore concept or recent events in their industry. Meyerowitz, a chain that operates 1,000-sq.-ft. optical stores in the New York area within blocks of Manhattan Eyeland, refused comment for this story.

Operators like Robert Fischer, district director of Medicare Vision Centers, a 12-store St. Louis chain, can point to difficulties even when startup costs are $100,000 for 1,000-sq.-ft. stores. The company has been in

business long enough to see paybacks in one to two years. Like others in the industry, he remembers when drug stores, mad for margins estimated to be 40% to 50% on optical goods, went whole hog into eyeglass departments. The ventures floundered for the most part seven or eight years ago because they lacked the optical expertise and staff to maintain customers.

These new marketers feel that they have the service and expertise problems licked in their businesses. For one thing, what Precision Lens Crafter's Butler called "an oversupply of opticians" is seen as a plus for chain employers. The U.S. Department of Commerce says there are 21,000 optometrists and 16,000 opticians in business, and *Optical Index*, a trade publication, reports that, "Even though the salary for private practice is virtually limitless, chains are still grabbing much of today's new talent by offering high starting salaries."

Labor costs, not unimportant to any retailer, are a critical factor to the megaopticals. Starting opticians command an average $16,500 salary, and novice optometrists start at slightly over $18,000. One of the prime features that separates superstores from the corner optical shop is their on-site laboratories which generally employ 10 to 15 skilled laboratory technicians.

"Payroll is the highest cost ingredient in this business," says Butler. He adds that not only is payroll as a percentage of sales higher than it is for other retail sectors, but that "payroll is higher than our cost of goods."

In fact, megaopticals clustered in large urban centers call for optimum service, from 15 to 30 employees per store, and a strong 10%-11% of sales commitment to advertising in order to gain market share. Industry observers note that some of these chains have spent $200,000 on grand opening campaigns. But the most fire power in their strategies is devoted to marketing.

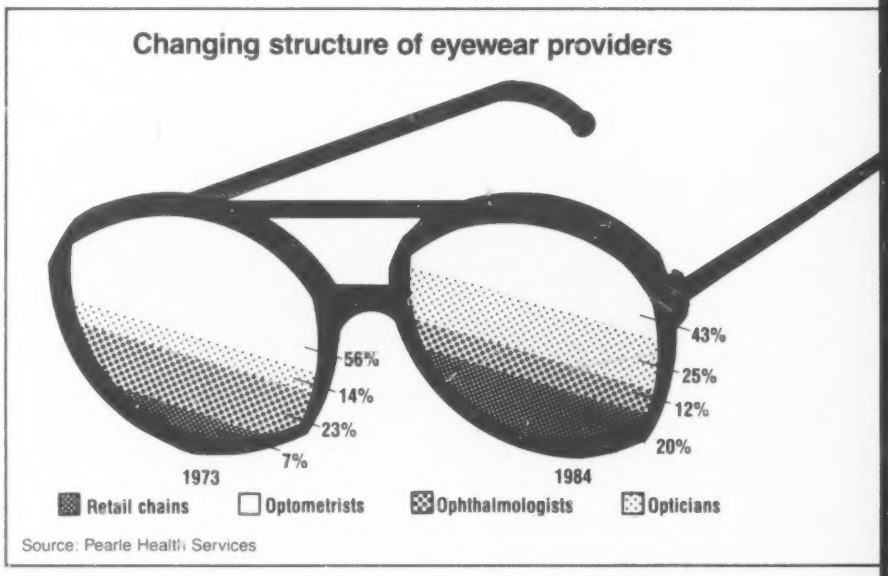
Several chief executives in the field hail from the granddaddy of all marketing—Procter & Gamble. Butler is a P&G graduate who feels the key opportunity in the optical trade is "expanding per capita consumption of eyewear." Manhattan Eyeland's chairman Jack Byrne, another P&G alumnus, says he sees no reason why he can't sell the public on day and evening glasses and winter and summer glasses. Per capita consumption slipped in recent years as the life of an average prescription lengthened from 2.3 years to 2.9 years.

Optical retailers doubt that the slippage was because of the nature of the consumers. The average consumer per capita expenditure on eyeglasses is $23 at present. That's because of the nature of the retailers in the optical business. The new marketers say they did their retailing like doctors.

"There are lots of millionaires in this business with one or two little 1,200-sq.-ft. stores," says Byrne, who explains that the doctors who traditionally dominated the industry never put their earnings back into the stores.

tors constitutes "a built-in conflict of interest," says Butler of Precision Lens Crafters. "Even in states such as Illinois, we won't put doctors on the payroll. There has always been a conflict since the majority of the income was generated by the sale of eyeglasses and not the service."

Medical records maintained by store doctors represent an impressive arsenal of marketing ammunition. The doctors' presence must generate sales in order to justify salaries which range from $40,000 to $100,000. At



The superstore operators are determined to pump up sales through innovative marketing and merchandising. Television advertising is frequent and sophisticated, although some traditional operators question the long-term effectiveness.

Keith West is president of Benson Optical (900-sq.-ft. stores and $60 million in annual glasses and contacts sales), a chain which recently doubled in size when it purchased 225 House of Vision stores. He calls Pearle Vision's ads the best in the industry. West thinks that other operators will imitate Pearle, "but after a period of time these ads may lose their appeal and customers may not come back. Our prescriptions come from doctors who don't sell glasses."

Butler: The key opportunity in the optical trade is "expanding the per capita consumption of eyewear"

In the few states where it is permissible to actually have doctors on the payroll—Nebraska, Illinois, New York and Michigan—opinions differ on whether the presence of the doc-

some locations, examinations alone can bring in significant revenues. Byrne estimates that 35% of sales at his store, opened in March 1984, stem from the $45 eye exams administered at Manhattan Eyeland. That price is well above the average $25 to $30 exams at other stores. However, the long-term value of the doctors' presence is the extensive computerized data kept on each patient's prescription and purchase that can be used for highly effective mail marketing campaigns.

Eyeworks, a three-store Minneapolis division of Cole National which opened in February, is also using computers in more of a marketing than a medical vein. A Digital Techniques Touchcom computer determines the customer's appropriate color palette and frame shape based on facial features, skin tone, hair and eye color.

Many of the stores draw salesmen who have fashion accessories experience in addition to opticians as sellers. That's a step that some old-line optometrists question, saying that proper fit is what brings a customer back.

But the superstores compensate with sophisticated computerized fit-

ters that determine the exact center of the lens in a person's line of vision to insure a good fit. Relying on more sophisticated exams and machinery may mean that all salesmen do not have to be opticians or apprentices, and that may help relieve the payroll pressure.

These fashion sales forces may be able to convince customers to buy colored contact lenses for cosmetic purposes (around $200 retail), and some of the ancillary high-end designer frames. Contact lens sales account for 20% of sales at most of the superstores, and the public's growing acceptance of contact lenses is still usually supplemented by a pair of backup glasses.

The fashion emphasis may help to stem the drifting of sales of nonprescription sunglasses from optical stores to department stores. A report by Corning Glass states that only 9% of sunglasses are sold at optical shops. Department stores got 31% of those sales, drug stores got 29%, discounters saw 12%, 5% went to variety stores and 14% was spent at unspecified locations.

Perhaps the only remaining caution that these megaoptical retailers take seriously is the danger of oversaturating common markets. "Clearly, these stores work best in high density areas with 500,000 people within five miles," says Butler. He mentions that Precision Lens Crafters has two stores in Cincinnati, but wouldn't like to get any smaller than that. "We wouldn't be brave enough to go to Lexington, Ky."

"Quaker and U.S. Shoe are buying management," says Joe Blackburn, chief executive officer of Eye + Tech, a Houston-based, four-unit superstore chain. He believes he needs a 300,000 to 400,000 population base to support his 5,000-sq.-ft. stores. But he stresses that "management will be more important than demographics in the long run."

While school is still out on the finer points of demographics in this industry, other executives are worried about oversaturation. Richard Golden, executive vp of D.O.C. Optics, does not subscribe to the 500,000 or bust theory. He says he is more concerned about density of population near the stores than the population of the city the store is located in.

"Look, we have one of these stores and we're pleased with it," says Golden. "But we're not saying for sure that it's the way we'll go in the future. It may not be the panacea that everyone thinks it is. What will happen when there are a lot of stores in every city? We're flexible enough to switch gears," says Golden. His chain is not opening 23,000-sq.-ft. stores in every location. The prototype will be 10,000 sq. ft. and will include lab, retail and stock. The Hialeah store is that large because its lab serves other stores.

When confronted with the possibility of overload in markets like Chicago, Butler of Precision Lens Crafters says, "There's a real possibility that they'll do themselves in. I don't know why they [Pearle, Eyelab, D.O.C. etc.] don't go somewhere else."

There will be a shakeout. Most companies, with the exception of Pearle and D.O.C. Optics, haven't even begun to establish distribution networks. MIS systems are five years behind the rest of the retail industry. Buyers are inexperienced in some sectors, and "suppliers in this industry are going to have to change rapidly in major ways. They're used to selling two or three frames a week."

Butler presents a likely scenario: "What will probably happen in the field will narrow to three or four operators who will dominate certain regions. It will be a Toys "R" Us—Children's Palace situation." ■

—Molly Brauer

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